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UNCLAS SECTION 01 OF 03 MADRID 003840

SIPDIS

SENSITIVE

E.O. 12958: N/A

TAGS: [PGOV](#) [ELAB](#) [SP](#)

SUBJECT: UNIONS PROTEST GOS PLAN FOR SAVING FAILING SHIPBUILDING INDUSTRY

REF: MADRID 3105

1. (SBU) Summary. Zapatero's Socialist (PSOE) government is facing its first labor crisis since taking office in April, as shipyard workers in five cities stage unruly protests and block traffic to protest GOS backing of a restructuring plan that will lead to significant layoffs. The heart of the issue is the inability of state-owned Izar Shipyards to compete with Asian shipbuilders and a demand by the European Commission (EC) that Spain repay at least USDOLS 370 million -- and possibly over USDOLS 1.35 billion -- in allegedly illegal subsidies provided to Izar in recent years by the previous Popular Party (PP) government. Labor frustrations burst into violent demonstrations in Cadiz and Vizcaya after Zapatero pledged to help workers, then subsequently announced his support for a company plan to split and partially privatize the failing enterprise, a plan that will result in job losses. A labor representative, who was preparing for a trip to the U.S. as an International Visitor grantee, told us the violence was regrettable, but indicative of the fear felt by Izar's 11,000 workers and 30,000 workers in affiliated industries. The GOS extracted a temporary reprieve from the EC regarding repayment of the illegal subsidies, taking the punch out of opposition arguments that the PSOE was acting on behalf of Brussels rather than Spanish workers. The GOS also put on hold its plans to divide the company while talks with the unions are underway. Unfortunately for Zapatero, there is no solution that will both save all Izar jobs and satisfy the EC that the GOS has ceased its illegal subsidies. Any viable solution is likely to incite another round of labor unrest. End Summary.

//AN UNWELCOME CONFRONTATION WITH LABOR//

2. (U) The Zapatero administration has attempted to shift the blame for the crisis to the PP for making the allegedly illegal payments to Izar, but PSOE remains on the defensive. All political parties except the PSOE joined a Congressional resolution calling on Zapatero to set aside the restructuring plan and demand lenient terms from the EC. Zapatero's government is attempting to do just that, but in the end the only question is how, not if, a large number of Izar employees will be removed from government payrolls.

//LAST GASP OF A DYING INDUSTRY//

3. (U) Over the last two decades, Spain's centuries-old shipbuilding industry has lost 30,000 jobs in a struggle for economic survival against Asian competitors, particularly South Korea. In 2000, the GOS folded its two remaining shipbuilding companies into a single company known as Izar as part of an effort to streamline the industry, but Izar has never shown a profit. Izar's 11,000 employees are now in danger of losing their jobs.

4. (SBU) It is the misfortune of the Zapatero administration that the final crisis has come on its watch. The Izar issue is coming to a head now in part because the opposition Popular Party (PP) delayed the inevitable by propping up the company through more than 1 billion euros (USDOLS 1.2 billion) in state funds, funds the European Commission (EC) has declared to be illegal subsidies and is now demanding Izar pay back to the GOS and the EU. The GOS estimates that if the parastatal company that owns Izar, Sociedad Estatal de Participaciones Industriales (SEPI), is forced to repay the full amount of illegal subsidies, Izar will go bankrupt within four months. To avert the total collapse of Izar, SEPI proposed separating the relatively viable military construction shipyards from the foundering civilian vessel shipyards and privatizing the civilian facilities. It is this SEPI survival strategy that has triggered violent protests by Izar workers throughout Spain and drawn Zapatero into an unwelcome conflict with labor.

//BACKGROUND TO THE CRISIS//

5. (U) Throughout its first term, Aznar's PP government maintained good working relations with labor unions and focused economic policy on job creation, dovetailing with union objectives for dealing with Spain's chronic high unemployment. After taking office in 1996, Aznar continued GOS support for a plan by the previous PSOE government to restructure the publicly owned shipyard industry, an

initiative that had the support of all major Spanish labor unions. The plan was intended to wean the shipyards away from state funding and require them to reduce labor and manufacturing costs.

16. (U) In 1997, the European Commission (EC) approved restructuring aid for the GOS-owned Spanish military shipbuilder Astilleros Espanoles, S.A. and the GOS-owned civilian shipbuilder Empresa Nacional Bazan amounting to EUR 1.38 billion (USDOLS 1.69 billion). EU funds were provided on the condition that no further subsidies would be provided to the companies.

17. (U) However, both companies failed to meet the objectives of the GOS restructuring plan and remained unprofitable. In 1999, Aznar's PP government authorized state-owned SEPI to grant EUR 500 million (USDOLS 615 million) in further aid to Bazan, assistance that eventually included SEPI's purchase of Bazan at allegedly above-market value. SEPI then purchased Astilleros in December 2000, forming Izar as Spain's last major civil and military shipbuilding company. Izar employs 11,000 shipbuilders in six cities throughout the country and 36,000 workers in related industries.

18. (U) The European Commission launched an investigation in 2000 to determine whether Aznar's assistance to Bazan and Astilleros constituted a violation of its 1997 agreement to provide restructuring aid. While the EC investigation was underway, the GOS provided another EUR 560 million (USDOLS 688 million) in subsidies to Izar. In May 2004, the EC determined that Spain's 1999 and 2000 assistance to the shipbuilders through SEPI and subsequent subsidies to Izar provided Spanish companies an uncompetitive advantage over other EU shipbuilders. The EC found that Izar must immediately repay EUR 308 million (USDOLS 378 million) and perhaps eventually up to EUR 1.1 billion (USDOLS 1.35 billion) in illegal assistance.

//LAST-DITCH SURVIVAL PLAN//

19. (SBU) In an effort to salvage what it can of the industry, SEPI has proposed dividing the civilian and military shipyards into two sets of companies, keeping the military shipyards (4 out of Izar's 10 facilities) under state ownership and privatizing the civilian shipyards. The PSOE government has also ramped up efforts to secure military sales for the remaining shipyards. SEPI is banking on Izar's relatively stable orders for military vessels to provide employment for at least several thousand Izar employees. (NOTE: One news report suggested that a recent Israeli decision to withdraw orders from Izar for two naval vessels was linked to USG displeasure with Zapatero's withdrawal of Spanish troops from Iraq. END NOTE.) The fate of workers in civilian shipyards would be far less certain.

10. (U) Shipyard workers met the SEPI plan with hostility from the outset and have staged sometimes violent strikes to make their position clear. Workers are against any division of the company or privatization of either the civilian or military sector based on their certainty that privatization will bring layoffs. They want Izar maintained as a single entity in order to guarantee that all workers will get the same deal.

11. (SBU) Labor's mood went from anger to outrage after Zapatero, during a visit to the Basque region, quelled a demonstration by Izar workers by promising he would stand with them, only to do an about-face and endorse the SEPI plan three days later. Workers reacted by announcing increased walkouts and temporary strikes. In Vizcaya and Cadiz, workers clashed with police and barricaded roads. Zapatero's reversal was cast as a major gaffe by opposition parties and the press and a reflection of inexperience and an inability to confront difficult issues directly.

12. (SBU) The GOS won a temporary truce with workers on 9/23 by agreeing to put the SEPI plan on hold while negotiations with labor unions are underway, but both sides appear entrenched in their positions. The next day, Minister of the Economy Pedro Solbes announced EC approval for a temporary reprieve on Izar while the GOS works out a solution with the unions. SEPI and labor union representatives traveled together to Brussels on 10/4 for meetings with the EC to establish the EC's bottom line on the matter. An EC spokesman suggested there could be "flexibility" on the schedule of repaying illegal subsidies, but only if SEPI's plan for separating Izar into military and civilian sectors were implemented. The EC estimates that splitting the companies will save 9,000 shipbuilder positions. Labor unions have continued intermittent work stoppages to keep up pressure on SEPI and the GOS during the negotiations.

//LABOR'S VIEW//

12. (SBU) Poloff met with Comisiones Obreras (CCOO) Director

for International Relations Javier Doz on 9/24 to discuss union views on the Izar crisis. (NOTE: Doz was preparing to depart for the U.S. on 9/25 as an International Visitor grantee. He is a long-standing and excellent contact on labor issues. END NOTE.) CCOO, a formerly Communist-aligned but now independent labor union, represents the largest number of shipbuilders and has played a leading role in the negotiations with SEPI and the Zapatero government. He explained that Izar workers are divided among all the major Spanish unions, guaranteeing a broad base of support for the shipbuilders. Doz said the SEPI plan would probably lead to 4,500 layoffs out of the total of 11,000 Izar direct-hires and to an unknown number of layoffs among the 30,000 workers in supporting industries. He said the outbreaks of violent demonstrations were regrettable, but that they reflected the fears of workers fighting for their economic lives. He expected Cadiz to be especially restive since a large number of workers in related industries in that city depend on Izar.

13. (SBU) Doz acknowledged that the long term prospects for shipbuilders were bleak, lamenting the fact that state-subsidized companies in Korea made Spanish firms that played by the rules of international competition unviable. However, Doz also noted that Korean firms were quicker to adapt to customer needs and were more technologically efficient than Spanish shipbuilders. Doz observed that even Izar's military shipyards suffer from lack of orders and cannot absorb the excess labor in the civilian shipyards. He said the CCOO and other unions were focused on getting the best deal they could for workers who will be forced from the industry. That could take the form of buyouts or favorable retirement packages, but SEPI and the unions are far from reaching any such arrangements. CCOO and the other unions also want the GOS to demand lenient terms from the EC, pointing out that larger EU countries don't refrain from pressuring the EC to bend the rules to protect domestic labor.

//POLITICAL FALLOUT//

14. (SBU) The demand that the PSOE stand up to the EU is aimed squarely at Zapatero, whose key policy foreign policy objective has been to "return Spain to the heart of Europe." He symbolically achieved this goal in early September, hosting Chancellor Gerhard Schroder and President Jaques Chirac for a meeting intended to signal a definitive break with Aznar's focus on transatlantic relations. The PP and other parties are now challenging Zapatero to use Spain's renewed EU credentials to extract favorable terms from Brussels regarding Izar's repayment of the illegal subsidies.

15. (SBU) The PSOE has blamed the PP for the Izar crisis because the allegedly illegal subsidies took place on Aznar's watch. The PP is unapologetic, saying Spanish workers should have priority over meeting EU agreements. Some observers have noted that all parties, including the PSOE, knew the PP subsidies to Izar were illegal and did nothing to stop them because no party wanted to accept responsibility for dooming the shipyards. PSOE made a vain appeal for other parties not to politicize the Izar issue, but on 9/21 all parties except PSOE supported a congressional resolution calling on the GOS to shelve the SEPI plan and demand better terms from the EU. The GOS responded that the only realistic choices were the SEPI plan or the total dissolution of Izar.

//COMMENT//

16. (SBU) This is not how Zapatero, who is mindful of the last PSOE administration's strained ties to labor, wanted to initiate his relationship with Spanish unions. His offer and subsequent retraction of support for the workers was especially embarrassing. However, Zapatero's administration, particularly Minister of the Economy Solbes, appears to have recovered from that gaffe and regained the initiative. The ability of the GOS to extract a positive response from the EC (at least for the moment) took the punch out of opposition argument that the PSOE was acting on behalf of Brussels rather than Spanish workers. Unfortunately for Zapatero, there is no solution that will both save all Izar jobs and satisfy the EC that the GOS has ceased its illegal subsidies. Any viable solution is likely to incite another round of labor unrest.

MANZANARES